

## University of Mississippi eGrove

---

Statements of Position

American Institute of Certified Public Accountants  
(AICPA) Historical Collection

---

1987

Proposed statement on auditing standards : communication with audit committees or others with equivalent authority and responsibility; Communication with audit committees or others with equivalent authority and responsibility; Exposure draft (American Institute of Certified Public Accountants), 1987, Feb. 14

American Institute of Certified Public Accountants. Auditing Standards Board

Follow this and additional works at: [https://egrove.olemiss.edu/aicpa\\_sop](https://egrove.olemiss.edu/aicpa_sop)

Part of the [Accounting Commons](#), and the [Taxation Commons](#)

---

### Recommended Citation

American Institute of Certified Public Accountants. Auditing Standards Board, "Proposed statement on auditing standards : communication with audit committees or others with equivalent authority and responsibility; Communication with audit committees or others with equivalent authority and responsibility; Exposure draft (American Institute of Certified Public Accountants), 1987, Feb. 14" (1987). *Statements of Position*. 501.  
[https://egrove.olemiss.edu/aicpa\\_sop/501](https://egrove.olemiss.edu/aicpa_sop/501)

This Book is brought to you for free and open access by the American Institute of Certified Public Accountants (AICPA) Historical Collection at eGrove. It has been accepted for inclusion in Statements of Position by an authorized administrator of eGrove. For more information, please contact [egrove@olemiss.edu](mailto:egrove@olemiss.edu).

# **EXPOSURE DRAFT**

## **PROPOSED STATEMENT ON AUDITING STANDARDS**

### **COMMUNICATION WITH AUDIT COMMITTEES OR OTHERS WITH EQUIVALENT AUTHORITY AND RESPONSIBILITY**

**FEBRUARY 14, 1987**

Prepared by the AICPA Auditing Standards Board  
For comment from persons interested in auditing and reporting

Comments should be received by July 15, 1987, and addressed to  
AICPA Auditing Standards Division, File 2347B  
1211 Avenue of the Americas, New York, N.Y. 10036-8775

## SUMMARY

### **Why Issued**

During audits of entities' financial statements, auditors acquire information that may help persons, such as audit committees or owners of owner-managed enterprises, fulfill their responsibility for overseeing auditing and financial reporting. Such information, however, has not always been communicated effectively. The Auditing Standards Board is issuing this Statement to increase the flow of useful information from auditors to audit committees and others with equivalent responsibilities.

### **What It Does**

This Statement establishes a new requirement that on all audits the auditor be assured that persons responsible for overseeing auditing and financial reporting, such as audit committees or owners of owner-managed enterprises, are informed about the following matters:

- Significant accounting policies
- Management judgments and accounting estimates
- Implications of audit adjustments
- Other information in documents containing audited financial statements
- An auditor's responsibility under generally accepted auditing standards
- Disagreements with management
- Major issues discussed with management prior to retention
- Difficulties encountered in performing the audit

### **How It Differs From Existing Standards**

This Statement does not amend or supersede an existing standard.

---

*This exposure draft has been sent to—*

- *Practice offices of CPA firms.*
  - *Members of AICPA Council and technical committees.*
  - *State society and chapter presidents, directors, and committee chairmen.*
  - *Organizations concerned with regulatory, supervisory, or other public disclosure of financial activities.*
  - *Persons who have requested copies.*
-



AICPA 100  
A CENTURY OF PROGRESS  
IN ACCOUNTING  
1887-1987

## American Institute of Certified Public Accountants

1211 Avenue of the Americas, New York, NY 10036-8775, Telephone (212) 575-8200

Telex: 70-3396, Telecopier (212) 575-3846

February 14, 1987

Accompanying this letter is an exposure draft of a proposed statement on auditing standards titled Communication With Audit Committees or Others With Equivalent Authority and Responsibility.

Audit committees have been assuming an increasingly important role in overseeing managements' financial reporting responsibilities and independent auditors' examinations of financial statements. Some believe, however, that audit committees and others, such as owners of owner-managed enterprises, who oversee financial reporting and auditing need more information about audits of financial statements and the results of those audits. The objective of this exposure draft is to increase the flow of useful information from auditors to audit committees or others with responsibilities equivalent to an audit committee's. Effective communication between auditors and those who oversee financial reporting and auditing is essential for both groups to successfully carry out their responsibilities.

The proposed SAS establishes a requirement that the auditor communicate to the audit committee or, in organizations without audit committees, to individuals with authority and responsibility equivalent to an audit committee's certain matters related to the conduct of an audit. The proposed Statement allows such communication to be written or oral. It also recognizes that, as long as the auditor is assured that the audit committee is informed, it may be appropriate for management to communicate certain of these matters and it may not be necessary to repeat communication of recurring matters year after year. This proposed Statement applies to all audits.

The proposed Statement requires the auditor to be assured that persons responsible for overseeing auditing and financial reporting are informed about the following matters:

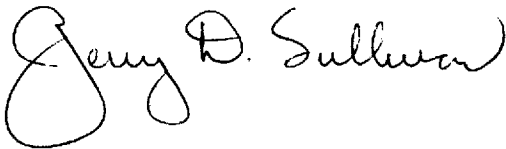
- The initial selection of significant accounting policies and their application
- The process management uses to prepare accounting estimates and the basis for the auditor's conclusions about the reasonableness of those estimates
- The implications of adjustments arising from the audit—both those that have been reflected in the financial statements and those that have not
- The auditor's responsibility for unaudited information in documents containing audited financial statements, the procedures performed, and the conclusions reached
- The level of responsibility the auditor assumes for an audit performed in accordance with generally accepted auditing standards and the nature of the assurance an audit provides
- All instances, including those that have been satisfactorily resolved, in which the auditor and management disagreed about matters that, individually or in the aggregate, could be significant to the entity's financial statements or the auditor's report
- Any major issues that management discussed with the auditor in connection with the retention of the auditor, including the application of accounting principles and auditing standards
- Any serious difficulties encountered that the auditor considered detrimental to the effective completion of the audit and indicative of conditions that could impair the financial reporting process

Comments or suggestions on any aspect of this exposure draft will be appreciated. The Auditing Standards Board's consideration of responses will be helped if the comments refer to specific paragraphs and include supporting reasons for each suggestion or comment.

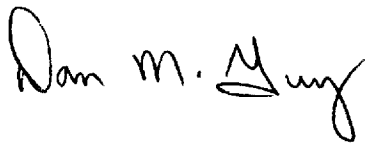
In developing guidance, the Auditing Standards Board considers the relationship between the cost imposed and the benefits reasonably expected to be derived from audits. It also considers differences that the auditor may encounter in the audit of the financial statements of small businesses and, when appropriate, makes special provisions to meet those needs. Thus, the board would particularly appreciate comments on those matters.

Written comments on the exposure draft will become part of the public record of the Auditing Standards Division and will be available for public inspection at the offices of the AICPA after August 17, 1987, for one year. Responses should be sent to the Auditing Standards Division, File 2347B, in time to be received by July 15, 1987. For convenience in responding, a perforated response form is attached and a postpaid return envelope is provided with this exposure draft.

Sincerely,

A handwritten signature in cursive script that reads "Jerry D. Sullivan".

Jerry D. Sullivan  
Chairman  
Auditing Standards Board

A handwritten signature in cursive script that reads "Dan M. Guy".

Dan M. Guy  
Vice President, Auditing

## PROPOSED STATEMENT ON AUDITING STANDARDS

### COMMUNICATION WITH AUDIT COMMITTEES OR OTHERS WITH EQUIVALENT AUTHORITY AND RESPONSIBILITY

1. This Statement establishes requirements for the auditor to communicate certain matters related to the conduct of an audit. Generally the communication would be to the audit committee or, in organizations that do not have an audit committee, to individuals with a level of authority and responsibility equivalent to an audit committee, such as the board of directors, the board of trustees, or an owner in owner-managed enterprises.<sup>1</sup>

2. Communication with the audit committee by the independent auditor on certain specified matters when they arise in the conduct of an audit is required by other standards.<sup>2</sup> Statement on Auditing Standards (SAS) No. 20, *Required Communication of Material Weaknesses in Internal Accounting Control* (AICPA, *Professional Standards*, vol. 1, AU sec. 323), requires the auditor to communicate to senior management and the board of directors or its audit committee material weaknesses in internal accounting control. (See also SAS No. 36, *Review of Interim Financial Information* [AICPA, *Professional Standards*, vol. 1, AU sec. 722].) SAS No. 16, *The Independent Auditor's Responsibility for the Detection of Errors or Irregularities* (AICPA, *Professional Standards*, vol. 1, AU sec. 327), requires the auditor to discuss material errors or irregularities involving senior management with the audit committee or board of directors. SAS No. 17, *Illegal Acts by*

*Clients* (AICPA, *Professional Standards*, vol. 1, AU sec. 328), contains a similar requirement regarding illegal acts performed by senior management.

3. This Statement does not modify the requirements of the statements mentioned above. Rather, it requires the auditor to communicate to the audit committee additional information regarding the scope and results of the audit that may assist the audit committee in overseeing the financial reporting and disclosure process for which management is responsible.

4. The communication may be oral or written. If information is communicated orally, the auditor should document the communication by appropriate memoranda or notations in the working papers. When the auditor communicates in writing, the report should indicate that it is intended solely for the use of the audit committee or the board of directors and, if appropriate, management.

5. All communications specified by this Statement are not required to occur before the issuance of the auditor's report on the entity's financial statements. The auditor should, however, consider whether information that relates to management's representations, or other matters, should be communicated prior to issuance of the report.

#### MATTERS TO BE COMMUNICATED

6. It may be appropriate for the communication of certain of the matters specified by paragraphs 7 through 16 below to be made by management. In addition, it may not be necessary to repeat the communication of recurring matters each year. Finally, this Statement is not intended to restrict the communication of other matters.

#### Significant Accounting Policies

7. The auditor should determine that the audit committee is informed about the initial selection of significant accounting policies and their application. The auditor should also determine that the audit committee is informed about the methods used to account for significant unusual transactions and the effect of ongoing accounting policies in controversial or emerging areas (that is, areas for which there is a lack of authoritative guidance or consensus). For example, significant accounting issues often exist in areas such as revenue recognition, off-balance-sheet financing, and accounting for equity investments. In order for the audit committee to make informed judgments, it considers the substance of these matters and the effect of alternative accounting principles. The auditor can facilitate this consideration by communicating to the audit committee information about the effects or implications of the accounting methods the entity uses, or proposes to use.

#### Management Judgments and Accounting Estimates

8. Accounting estimates are an integral part of the financial statements prepared by management, and are based upon management's current judgments. Those judgments are normally based on knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments. The auditor should determine that the audit committee is informed about the process used by management in formulating such accounting estimates and about the basis for the auditor's conclusions about the reasonableness of those estimates.

<sup>1</sup> This Statement is not intended to require communication with individuals who are not responsible for the oversight of the financial reporting process. This Statement is also not intended to require communication when all members of such boards or individuals are part of management of the organization so long as these communications have been substantively performed as part of the audit.

<sup>2</sup> The Auditing Standards Board has also exposed for comment a proposed SAS titled *The Communication of Control-Structure Related Matters Noted in an Audit* that, if adopted, would also require communication with the audit committee.

### **Implications of Audit Adjustments**

9. The auditor should inform the audit committee about the implications of adjustments arising from the audit—both those that have been reflected in the financial statements and those that have not. An audit adjustment is a proposed correction of the financial statements detected as a result of applying auditing procedures, and which in the auditor's judgment may not have been detected otherwise. Adjustments proposed by the auditor, whether or not recorded by the entity, may have implications regarding the control structure of the entity. Adjustments proposed by the auditor, but not recorded by the entity, may also have implications for future financial statements even though the auditor has concluded that they are not material to the current financial statements.

### **Other Information in Documents Containing Audited Financial Statements**

10. The audit committee often considers information prepared by management that accompanies the entity's financial statements. An example of information of this nature would be the "Management Discussion and Analysis of Financial Condition and Results of Operations." SAS No. 8, *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 550), establishes the auditor's responsibility for this information.<sup>3</sup> The auditor should discuss with the audit committee his responsibility for other

information in documents containing audited financial statements, the procedures performed, and the results.

### **Auditor's Responsibility Under Generally Accepted Auditing Standards**

11. An audit performed in accordance with generally accepted auditing standards may address many of the concerns of an audit committee. For example, an audit committee is usually concerned about the control structure and about whether the financial statements are intentionally or unintentionally misstated. In order for the audit committee to understand the nature of the assurance provided by an audit, the auditor should communicate the level of responsibility assumed for these matters under generally accepted auditing standards. It is also important for the audit committee to understand that an audit conducted in accordance with generally accepted auditing standards is designed to provide reasonable, rather than absolute, assurance about the financial statements. Communication with the audit committee about the concepts of materiality, audit tests, and reasonable assurance contributes to this understanding; this often can be accomplished in an engagement letter.

12. The audit committee may have specific concerns that may not be addressed by the procedures that the auditor considers necessary to express an opinion on the entity's financial statements. Communication with the audit committee about the intended scope of the current year's audit allows the audit committee to consider whether the auditor should be engaged to perform additional procedures that address these concerns.

### **Disagreements With Management**

13. Accounting principles are often stated in broad terms that are applied by analogy to similar circumstances. Therefore, disagreements occasionally arise with management over the application of accounting principles to the entity's specific transactions and events. Disagree-

ments may also arise regarding the scope of the audit, disclosures to be included in the entity's financial statements, and the wording of the auditor's report. The auditor should discuss with the audit committee any disagreements with management,<sup>4</sup> whether or not satisfactorily resolved, about matters that individually or in the aggregate could be significant to the entity's financial statements or the auditor's report. For purposes of this Statement, disagreements do not include differences of opinion based upon incomplete facts or preliminary information that are later resolved.

14. In the vast majority of cases, the disagreements described above are readily resolved. In some cases, however, management may decide to consult with other accountants. The auditor should discuss with the audit committee his views about matters that were the subject of such consultation.<sup>5</sup>

### **Major Issues Discussed With Management Prior to Retention**

15. If the audit committee is not involved in the auditor selection and retention process, the auditor should discuss with the audit committee any major issues that were discussed with management in connection with the retention of the auditors, including, among other matters, any discussions

<sup>3</sup> Guidance on the auditor's consideration of other information is also provided by SAS No. 27, *Supplementary Information Required by the Financial Accounting Standards Board* (AICPA, *Professional Standards*, vol. 1, AU sec. 553); SAS No. 28, *Supplementary Information on the Effects of Changing Prices* (AICPA, *Professional Standards*, vol. 1, AU sec. 554); SAS No. 29, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents* (AICPA, *Professional Standards*, vol. 1, AU sec. 551); SAS No. 37, *Filings Under Federal Securities Statutes* (AICPA, *Professional Standards*, vol. 1, AU sec. 711); and SAS No. 40, *Supplementary Mineral Reserve Information* (AICPA, *Professional Standards*, vol. 1, AU sec. 556).

<sup>4</sup> The glossary to Financial Accounting Standards Board (FASB) Statement No. 57, *Related Party Disclosures*, defines management as follows:

Persons who are responsible for achieving the objectives of the enterprise and who have the authority to establish policies and make decisions by which those objectives are to be pursued. Management normally includes members of the board of directors, the chief executive officer, chief operating officer, vice presidents in charge of principal business functions (such as sales, administration, or finance), and other persons who perform similar policy-making functions. Persons without formal titles also may be members of management.

<sup>5</sup> See SAS No. 50, *Reports on the Application of Accounting Principles* (AICPA, *Professional Standards*, vol. 1, AU sec. 625), for the requirement of a reporting accountant, as defined, to consult with a principal's continuing accountant when evaluating accounting principles or determining the type of opinion that may be rendered on an entity's financial statements at the request of a principal or an intermediary acting on behalf of a principal.

regarding the application of accounting principles and auditing standards.

***Difficulties Encountered in Performing the Audit***

16. The audit committee should be informed of any serious difficulties

encountered that were considered detrimental to the effective completion of the audit and that may be indicative of conditions that could impair the financial reporting process. This includes, among other things, matters such as the unavailability of client personnel, the failure

of client personnel to complete audit schedules on a timely basis, unreasonable delays by management in permitting the commencement of the audit or in providing needed information, and whether the timetable set by management was detrimental to the audit.



**Response Form Follows**

**FILE 2347B**

**Name and Affiliation:**

TEAR ALONG DOTTED LINE

**This perforated response form may be used for comments or suggestions relating to any aspect of the exposure draft that is of concern or interest to you. For convenience, the most significant points have been identified in the summary that accompanies this exposure draft.**

Comments (continued): \_\_\_\_\_

This image shows a single sheet of white paper with horizontal ruling lines. The lines are evenly spaced and run across the width of the page. There are no margins, text, or other markings on the paper.